

**Rating Action: Moody's affirms KLP Banken's A2 ratings; upgrades BCA to baa1**

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London, 26 September 2017 -- Moody's Investors Service, ("Moody's") has today affirmed KLP Banken AS's (KLP Banken) A2/Prime-1 long and short-term deposit ratings respectively. The outlook on the long-term deposit ratings is stable. At the same time, Moody's has upgraded the baseline credit assessment (BCA) to baa1 from baa2 and the adjusted BCA to a3 from baa1. The rating agency has also upgraded the long-term counterparty risk assessment (CR Assessment) to Aa3(cr) from A1(cr) while short-term CR assessment was affirmed at P-1(cr).

The upgrade of the BCA to baa1 is primarily driven by the bank's: (1) increased capital buffers and (2) an improving funding profile with increasing amounts of deposits, albeit still highly reliant on market funding; together with (3) a very low asset risk resulting from its specific business model, which combines lending to public sector and retail mortgage customers. These credit strengths are balanced against KLP Banken's (4) low but improving profitability as the bank grows its retail lending book.

The affirmation of KLP's A2 deposit ratings reflects the improved standalone credit profile of the bank, as captured by the upgraded BCA of baa1, a very high probability of affiliate support which results in an adjusted BCA of a3, and the concurrent offsetting movement in the rating uplift that the bank receives from our Advanced Loss Given Failure (LGF) analysis, moving to one notch from previous two notches. With a declining trend in unsecured debt, our assessment of the cushion of debt that would protect senior creditors in case of bail in has decreased.

A list of ratings is provided at the end of this press release.

**RATINGS RATIONALE**

**BASELINE CREDIT ASSESSMENT**

The primary drivers for the upgrade in the bank's BCA to baa1 are the recent strengthening in capitalization and its gradual improvements in its funding profile. Capitalization of the bank has increased in recent quarters with Common Equity Tier 1 ratio increasing to 19.3% at the end of June 2017 from 16.5% at the end of June 2016, mainly through a capital injection of NOK 250 million in response to leverage ratio requirements. The bank also improved its leverage ratio to 5.1% in June 2017, above the 5% regulatory requirement, from 4.3% reported in June 2016.

Consequently, the bank has managed to accumulate large capital buffers with a substantial loss absorption capacity that provides protection against future losses.

Moody's expects that the bank will continue to improve its funding profile, by gradually increasing volumes of deposits while maintaining a lower share of unsecured market funding than in previous years. The deposit base with deposits from individuals, public sector entities and companies increased to 27% of total liabilities at end-June 2017, compared with 25% in June 2016. At the same time, senior unsecured funding decreased to NOK 1.5 billion (4.7% of liabilities at end-June 2017 from 8.9% at end-June 2016). As of end-June 2017, total issued securities accounted for 72% of total liabilities.

While Moody's sees some potential downside risk given the material refinancing needs, the rating agency considers the covered bonds issued by KLP Kommunekreditt AS (NOK 17.9 billion public covered bonds outstanding, 54% of total liabilities) and KLP Boligkreditt AS (NOK 4.3 billion retail covered bonds outstanding at end June 2017, 13% of liabilities) as less confidence sensitive than, for example, unsecured and short-term market funding (5% of liabilities). Market participants have demonstrated appetite for covered bonds given the high quality of the collateral mitigating the refinancing risk.

KLP Banken's liquidity profile is in line with Norwegian peers, as the bank has obtained more funding than required to meet its operational needs. Liquid banking assets stood at 11.6% June 2017, in line with Moody's rated Norwegian savings banks.

Furthermore Moody's expects that KLP Banken will continue to demonstrate a sound asset quality with very low levels of problem loans (0.08% of gross loans in June 2017), reflecting the low risk in Norwegian public sector and retail lending. Although the growth in retail mortgages will, over time, bring about higher levels of problem loans, the bank will compare favourably compared to its Norwegian peers. The target customer segment, employees in the public and healthcare sectors represent a low risk segment with low risk of unemployment. Additionally, the bank only accepts primary home mortgages, and therefore has no buy-to-let in its portfolio.

Profitability is gradually improving over time as the banks business mix is increasingly diversified, but growth is constrained by capital. Moody's expects moderate improvements as the bank increasingly focuses on lending to retail customers and launches additional products aimed at the retail market. Net income/tangible assets amounted to 0.21% for the first six months of 2017, unchanged from FY 2016 and up from 0.12% in 2015. However, Moody's expect profitability improvements to be moderate and gradual given the country's high level of competition within the mortgage market, and the low interest rate environment. Furthermore, growth is constrained by the limited internal capital generation in an environment where capital requirements have become increasingly higher.

#### RATIONALE FOR THE AFFIRMATION OF KLP BANKEN'S DEPOSIT RATINGS

The primary drivers of the affirmation of KLP Banken's A2/Prime-1 deposit ratings are the adjusted BCA of a3, one notch of affiliate support and one notch (previously two notches) of uplift according to the rating agency's advanced Loss Given Failure (LGF) analysis, reflecting the lower amounts of protection offered by the bank's liability structure. The volumes of senior unsecured debt has dropped to 4.4% of tangible banking assets (TBA) from 6.9% at year-end 2016. The decreased volume of senior unsecured debt leads to low expected loss to junior depositors in the unlikely event of the bank's failure and resolution.

The affiliate support uplift reflects Moody's view that KLP will likely provide support to KLP Banken, if needed, given the importance of the bank to its business strategy. The one notch of uplift under Moody's advanced LGF approach reflect the view that deposits are likely to face low loss-given-failure, due to the loss absorption provided by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the volume of deposits themselves.

#### COUNTERPARTY RISK ASSESSMENT

The upgraded Aa3(cr) long term and affirmed P-1(cr) short-term CR Assessment under KLP Banken are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default; and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities, bank's critical functions.

KLP Banken focuses on lending to Norway's municipalities, county administrations and companies carrying out public sector and enterprises assignments (56% of the total loans as of the end-June 2017), and is increasingly providing mortgage loans to the retail market, prioritising customers of its parent Kommunal Landspensjonskasse (KLP, A2 insurance financial strength, stable) (44% of total loans). The bank does not have a branch network and distributes its products online.

#### Rating Outlook

The stable outlook on KLP Banken's long-term deposit ratings reflects Moody's view that the bank's financial standing will remain broadly resilient to a modest slowdown in Norway's economy.

#### LIST OF AFFECTED RATINGS

Issuer: KLP Banken AS

#### Upgrades:

...Adjusted Baseline Credit Assessment, Upgraded to a3 from baa1

...Baseline Credit Assessment, Upgraded to baa1 from baa2

...LT Counterparty Risk Assessment, Upgraded to Aa3(cr) from A1(cr)

Affirmations:

...LT Bank Deposits, Affirmed A2, Outlook Remains Stable

...ST Bank Deposits, Affirmed P-1

...ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Actions:

...Outlook, Remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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